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United States Senate

COMMITTEE ON BANKING, HOUSING, AND
URBAN AFFAIRS

WASHINGTON, DC 20510-6075

December 19, 2002

The Honorable Mel Martinez
Secretary
Department of Housing and Urban Development
451 7th Street, S.W.
Washington, D.C. 20410

Dear Mr. Secretary,

We appreciate the opportunity to comment on the Department of Housing and Urban Development's (HUD) proposed changes to the regulations governing the Real Estate Settlement Procedures Act (RESPA). The proposal is extremely complex and potentially wide-ranging, both in its own right, and with regards to the impact changes to RESPA rules may have on currently existing and crucial consumer protections provided by other laws. HUD has an opportunity to act in a way that maintains the important protections contained in the Truth in Lending Act (TILA) and improve the real outcome for mortgage borrowers.

Broadly speaking, the proposal includes two basic parts: important improvements to the current mortgage delivery system dealing with the Good Faith Estimate (GFE) and compensation for mortgage brokers through yield spread premiums; and, the "Guaranteed Mortgage Package" (GMP) which would likely result in significant changes to the way in which mortgages are currently offered. This letter addresses a number of key issues in each of these areas.

I. The Good Faith Estimate

Both the proposed rule and the 1998 "Joint Report to the Congress" by HUD and the Federal Reserve Board (Fed) make it clear that the current system fails to adequately serve the needs of consumers. Specifically, the current system provides the consumer with information that is simply too uncertain, too expensive, and/or too late in the process to allow them to shop for a mortgage effectively. Indeed, all too often, the current GFE has become a tool to lure borrowers, particularly subprime borrowers, to the closing table, at which time many discover the final costs significantly exceed those on the GFE. Unfortunately, many of these borrowers find themselves in a "take-it-or-leave-it" situation and must proceed with the loan despite the unexpected costs.

For these reasons, we support HUD's proposal to make the GFE more accurate. In particular, the proposal to require origination charges to be fully, precisely, and accurately disclosed in the GFE is both reasonable and fair. Lenders and other originators should know their fees at the time they provide a GFE. The tolerance for these charges should be no more than 10 percent, as suggested by HUD.

In order to make these provisions effective in the marketplace, HUD should amend its proposal to state that any charge beyond the tolerances permitted by the new regulation be considered an unfair and deceptive practice. This will create an enforcement mechanism for borrowers who are victimized by originators who do not live up to their GFE commitments. Without this change, too many lenders will be tempted, once again, to use the GFE as a tool to bait and switch borrowers because they are unlikely to pay any penalty for failing to comply with the new rule.

We also strongly support the requirement for mortgage brokers to disclose their total compensation in the form of a binding agreement with the consumer. It is common sense that a consumer should be told of the price of the service being offered prior to buying that service. American homebuyers should have the option of shopping for their mortgage broker on the basis of the broker's charges in the same way they shop for any other service.

We further support the proposal that any yield spread premiums paid by the lender go directly to the borrower. This should appear as a cash credit to the borrower so as to ensure that it is treated consistently in all transactions. As you know, the Senate Committee on Banking, Housing, and Urban Affairs held a hearing on yield spread premiums (YSPs) earlier this year. The hearing showed that many consumers are, without their knowledge, steered to higher cost loans by brokers who receive YSPs from lenders in return for closing the higher rate loans. Moreover, most consumers never know that the broker receive this compensation. The industry has justified this practice by saying that YSPs make no or low closing cost loans possible because these lender payments offset such costs. However, studies provided to the Committee at the hearing, as well as further research conducted by Freddie Mac, shows that the bulk of these YSPs go to increase the compensation of the brokers rather than offset closing costs associated with the loan. Indeed, the Committee was provided with testimony that indicates that lenders pay YSPs as a way to attract business from brokers, without regard to any services rendered or facilities provided. In such cases, YSPs are simply payments for the referral of business, which violate section 8 of RESPA.

Requiring that YSPs go to the borrower would prevent mortgage brokers, as the proposal points out, from:

... increas[ing] their compensation without the borrower's knowledge, by placing the borrower in an above par [higher cost] loan and receiving a payment from the lender (yield spread premiums)....

Instead, the new rule would ensure that "maximum mortgage broker compensation will be clear and brokers will have no incentive to seek out lenders paying the largest yield spread," as the proposal states. Under this regime, if properly instituted and with sufficient enforcement, the interests of the broker will be aligned with the interests of the borrower "to find the best loan product [the broker] can for the borrower," as the rule says.

To ensure that you get this desirable outcome, it is not enough to require that brokers commit to a maximum level of compensation, and that YSPs be credited to the borrowers. HUD should go further and make sure that these provisions are fully and effectively enforceable. A number of steps must be taken to achieve this goal.

A. The provisions dealing with YSPs should be put in the regulations prohibiting kickbacks and unearned fees (24 CFR 3500.14). It is clear from the testimony presented at our hearing, and from legal actions and other studies, that many YSPs currently paid by lenders are illegal referral fees. As the proposed rule recognizes, the current system creates incentives for mortgage brokers to "seek out lenders paying the largest yield spread;" in other words, to refer business to those lenders who offer the greatest payments for those referrals. Because this is a violation of section 8, the regulations governing these payments properly belong in section 24CFR 3500.14.

B. In addition, to make the YSP and GFE proposals effective, the rule should be amended to allow for private enforcement, including the use of class actions. HUD, particularly given tight budgets, will not be able to enforce many of the provisions of this rule by itself. It was asserted that HUD's October, 2001 policy "clarification" on the issue of YSPs, which undermined the ability of consumers to seek redress for being steered into higher rate loans, was premised on the concern that existing rules under RESPA were not clear. However, once this new proposal is implemented, all lenders, brokers, and other market participants will know the rules. HUD should not undercut courts who may agree that violations by particular companies are subject to class actions.

We have a number of other suggestions on the proposed GFE changes. The proposed language regarding the broker relationship to the borrower is likely to be confusing and does not promote a better or more efficient mortgage origination process. In addition, we have repeatedly seen that mortgage brokers market themselves as representatives of the borrower, notwithstanding simultaneous claims that brokers are independent. For example, materials printed by the National Association of Mortgage Brokers (NAMB) describes the mortgage broker as "an expert mentor," (i.e. trusted advisor) to guide the consumer "through the complex mortgage origination process." Finally, it is our understanding that, under a number of state laws, brokers do have an agency relationship with the borrower. HUD should not interfere with these or other state laws dealing with the mortgage process. Finally, the comparison chart on the GFE form should include the actual terms that are being offered to the borrower.

II. The Guaranteed Mortgage Package

The Guaranteed Mortgage Package (GMP), *if implemented correctly*, has the potential to reduce costs through enhanced competition where markets function effectively. However, HUD must be certain that the use of the GMP does not facilitate predatory lending by eliminating existing substantive protections under the Truth in Lending Act (TILA), particularly for subprime borrowers. Much of the proposed rule under discussion seems to be based on the 1998, HUD/Fed Report on the reform of RESPA and TILA. One key element of the Report was the finding that RESPA and TILA reform should take place simultaneously with new legislation that provides substantive protections against predatory lending. While a rulemaking alone cannot create new statutory protections, HUD should do everything possible to avoid undermining the important and substantive protections noted in the HUD/Fed Report that are currently provided by TILA. Any other course of action would, in effect, put HUD in the position of creating a safe harbor for unscrupulous, predatory lenders who prey disproportionately on minorities, immigrants, the elderly, and low income homeowners.

To make sure the GMP works in a constructive manner, we recommend the rule adopt the following changes:

A. The GMP should be limited to the prime market only. The evidence is clear that predatory lending is largely a function of the subprime market. As stated above, applying the package to the subprime market will undermine current consumer protections without replacing them with any alternatives. This is because the package would eliminate the need to list specific fees for different goods and services, which are needed to enforce TILA. Losing the ability to enforce TILA will result in real harm to those borrowers who are already the most vulnerable. HUD should not put itself in a position of creating more opportunities for unscrupulous mortgage lenders, brokers, and others to take advantage of minorities, the elderly, and working Americans who borrow in the subprime market.

Extensive testimony taken at the recent Senate hearings, a 1998 hearing held by the Senate Aging Committee, and hearings held in both the House and Senate prior to the passage of the Home Owners and Equity Protection Act (HOEPA) in 1994 show there are major deficiencies in the functioning of the subprime market. The recent settlements of the Federal Trade Commission and the Attorneys General of several states with two of the largest subprime lenders in the nation document the kind of practices in which even the largest, most visible subprime lenders engage. Affidavits by employees of these large companies further attest to the effort many subprime lenders put into targeting and then taking advantage of subprime borrowers, pushing them deeper into debt and stripping their hard-earned home equity. Taken as a whole, this evidence clearly indicates that one of the key characteristics of this market is that lenders shop for borrowers rather than the other way around. The GMP will not resolve this basic problem. These lenders will simply build their higher costs into the package.

HUD can avoid making the GMP apply to the subprime market by prohibiting the use of the package for all HOEPA loans, loans with prepayment penalties, and loans with a guaranteed mortgage price of 5% of the principal of the loan or higher. These are overwhelmingly characteristics of subprime and predatory loans.

On the other hand, the GMP can work effectively in the prime market. At least one very large lender is already offering a guaranteed interest rate and closing cost package. Given the technology available in today's marketplace, the GMP should be able to be offered shortly after the rule is finalized.

B. The GMP should include, as HUD proposes, both a guarantee on a mortgage rate and closing costs. The guaranteed interest rate can be subject to the fluctuations of the marketplace, as the rule suggests. That guarantee can be tied to a particular loan product which the consumer has been offered through the GMP, so long as the consumer can monitor that rate on an ongoing basis.

The guaranteed price must be subject only to the confirmation of information requested by the packager. The rule in no way limits the amount of information the lender may request prior to making the offer. This should adequately protect lenders and packagers. The offer must be firm if the consumer is going to use it as a tool to shop, as HUD intends. The proposed rule is ambiguous on this point. We urge HUD to clarify that only material differences in information provided by the consumers may be grounds for revoking the GMP offer.

C. HUD should confer with the Federal Reserve Board to make sure that closing costs within the package are treated in a uniform manner for TILA purposes. The key advance that the GMP would represent would be that consumers would get one or two easily understandable prices with which they can comparison shop. One such price is the annual percentage rate (APR). However, the calculation of the APR can change depending on how certain closing costs are characterized. That means that the exact same loan – same principal, same interest rate, same term, same closing costs – may actually have different APRs depending on how certain closing costs are listed for TILA purposes. This could result in lenders “gaming” the APR to mislead consumers, thereby undermining the very purpose of the GMP and limiting consumers’ ability to seek relief for possible TILA violations. HUD should work with the Fed, prior to releasing the final rule, to make sure packagers treat these costs in a consistent manner.

D. The GMP must be effectively enforceable by consumers. The current proposal does not provide any adequate enforcement by consumers for packagers who do not live up to their GMP commitments. As with the GFE, there has to be some penalty for failure to follow the rules, or originators will ignore those rules when it is to their advantage to do so. The main benefit of the GMP option to the originator or packager is the exemption from section 8 anti-kickback provisions. Simply removing this exemption upon failure to honor the GMP is not adequate, especially because the nature of the package means that consumers will not have the detailed information on payments among settlement service providers necessary to show a

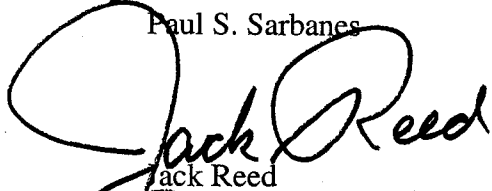
section 8 violation. The best way to ensure that adequate enforcement will take place is to make it clear in the final rule that the failure to honor a GMP offer creates the presumption of a RESPA section 8 violation that can be privately enforced, including through class action litigation.

Thank you for your consideration of our views.

Sincerely,



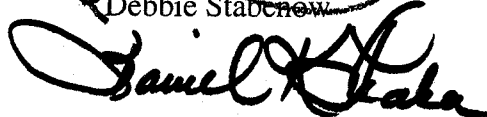
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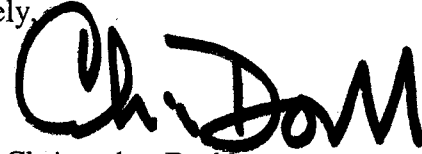
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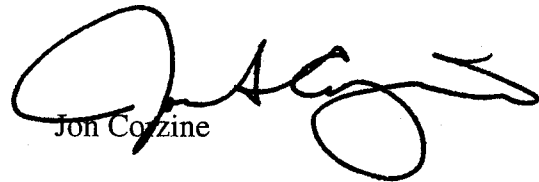
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